

BEFORE THE POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Statutory Review of the System for
Regulating Rates and Classes for
Market Dominant Products

Docket No. RM2017-3

REPLY COMMENTS OF PITNEY BOWES INC.

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Pitney Bowes Inc. (Pitney Bowes) respectfully submits these reply comments in response to Order No. 4258.¹

I. INTRODUCTION AND SUMMARY

The initial comments filed in this proceeding confirm that the Commission's proposed changes to the workshare regulations are improvements and should be adopted with the modifications proposed by Pitney Bowes and others to maximize incentives for pricing and operational efficiency.

Accordingly, consistent with the Commission's prior holding that workshare discounts must be set consistent with the principles of efficient component pricing (ECP) to achieve the statutory objectives, Greeting Card Association's (GCA) proposal to allow workshare discounts to deviate substantially from ECP should be rejected. The initial comments further underscore that the Commission's implementation and enforcement of the proposed changes to the workshare rules will be critical to realizing the efficiency goals of the PAEA.

GCA is the only party to challenge the Commission's holding that sections 3633(a)(3) and 3633(b) have proven effective in allocating institutional costs between market dominant and competitive products.² GCA's position that section 3622(b)(9) imposes an independent minimum share requirement on competitive products is incorrect and would introduce a conflict among the statutory provisions where none exists. The Commission's interpretation reconciles all of the relevant statutory provisions and correctly recognizes that the specific mechanisms in section 3633 satisfy the goal of Objective 9.

¹ Order No. 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products (NPRM) (Dec. 1, 2017).

² See Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

II. DISCUSSION

A. The Commission's Proposed Changes to the Workshare Rules Should be Adopted, as Modified, to Maximize Pricing and Operational Efficiency

The initial comments filed in this proceeding confirm that the Commission's proposed changes to the workshare regulations are improvements and should be adopted with the modifications proposed by Pitney Bowes and others to maximize incentives for pricing and operational efficiency. The overwhelming majority of commenters support the Commission's proposal to promote ECP by establishing bands - ranges of upper and lower limits - for workshare discount passthroughs. These parties, in addition to Pitney Bowes, include the American Bankers Association, the Major Mailers Association, the National Association of Presort Mailers, the National Postal Policy Council, and ValPak Direct Marketing Systems Inc. and ValPak Franchise Association, Inc.³

Several parties, including Pitney Bowes, propose modifications to the Commission's proposal, consistent with Objective 1, to maximize incentives to promote efficiency. Specifically, several parties urge the Commission to adopt narrower bands. The ABA, MMA, NAPM, NPPC, and Pitney Bowes all urge the commission to narrow the bands for First-Class Mail and Marketing Mail workshare discounts to 95 to 105 percent. *See e.g.*, ABA Comments at 12 ("The proposed band of 85-115 percent is too loose. The bands should be narrowed to 95-105 percent."); NPPC et al. Comments at 42 ("the proposed 30 percent range for the band is too broad. Instead, for First-Class and Marketing Mail, a range more consistent with maximizing the incentives for pricing efficiency would be between 95 and 105 percent. . . . The narrower the

³ See Comments of American Bankers Association (ABA) (Mar. 1, 2018) at 12-13; Initial Comments of the Greeting Card Association (GCA)(Mar. 1, 2018) at 19; Comments of the National Postal Policy Council (NPPC), the Major Mailers Association (MMA), and the National Association of Presort Mailers (NAPM)(Mar. 1, 2018) at 41-42; Initial Comments of Pitney Bowes Inc. (Pitney Bowes)(Mar. 1, 2018) at 9-10; Initial Comments of ValPak Direct Marketing Systems, Inc. and the ValPak Franchise Association, Inc. (ValPak)(Mar. 1, 2018) at 18-19.

range of the band, the more efficient and cost-effective the price signals will be.”); Pitney Bowes Comments at 10-11 (“A 30 percent range does not *maximize* incentives or use workshare discounts *to the fullest extent possible* to reduce costs and increase efficiency. A tighter range is required. The Commission should revise its proposal to set the upper and lower limits at 95 percent and 105 percent. A narrower range is compelled by the statutory command to “maximize” incentives in Objective 1.” (emphasis in original)).

The Commission should modify the proposal to adopt narrower bands. Narrower bands would better promote ECP and do more to maximize incentives to promote pricing and operational efficiency as required by Objective 1. Moreover, as pointed out in Pitney Bowes’ initial comments, recent rate design improvements in First-Class Mail and Marketing Mail Automation letters demonstrate that it is feasible for the Postal Service to set workshare discounts within the more efficient range of 95 percent to 105 percent. *See* Pitney Bowes Comments at 11-12.

For these same reasons, the Commission should reject GCA’s proposal to lower the lower band as inconsistent with Objectives 1 and 5. GCA’s “asymmetric” lower band proposal fails on several levels. First, GCA’s proposal misapprehends the theoretical basis of ECP. The fact that *some* mailers may be willing to do the work for less than the full value of the avoided cost is a not a reason to deviate from the principle of ECP pricing - which GCA itself acknowledges is the “correct basis for thinking about how to calculate workshare discounts.” GCA Comments at 19. A central premise of ECP is that it is not realistic to expect the Postal Service to simultaneously know or to be able to engage in negotiations with every mailer as to that mailer’s specific costs:

efficient “make or buy” negotiations . . . can be decentralized using ECPR-based worksharing discounts set equal to the per unit avoided costs of the Postal Service. This leads mailers to choose to perform work sharing if and only if doing so lowers total postal sector costs. The reason is quite intuitive. If the mailer’s

cost is less than the discount offered, it is profitable for the mailer to do the work – and total postal sector costs decrease. If the discount is not sufficiently attractive, the Postal Service continues to provide the service component.

[ECP] is the only discount policy that will allow the decentralized actions of mailers and consolidators to assist the Postal Service in minimizing the total costs of the postal sector. This is the case, because, if the worksharing discount is less than the unit avoided costs of the Postal Service, some mailers who could provide the service more cheaply than the Postal Service will not have an incentive to engage in worksharing. On the other hand, if the worksharing discount is greater than the per unit avoided costs of the Postal Service, there will be mailers who will take advantage of the discount even though they cannot perform the service as cheaply as the Postal Service. In either case, the total costs of the end-to-end service will increase.⁴

Additionally, the Commission has long recognized that the relevant consideration in designing efficient workshare prices is the Postal Service's costs, not the costs of a hypothetical mailer.⁵

GCA's proposal also ignores the negative effects on pricing and operational efficiency of setting workshare discounts substantially below avoided costs. In its initial order the Commission correctly held that "workshare discounts reflect ECP and result in the most efficient outcome when they are set equal to their corresponding avoided costs."⁶ The Commission further held that this type of "pricing efficiency also promotes fair competition, because it allows mailers to determine if they can prepare the mail at a lower cost than paying the Postal Service to do the work."⁷ The Commission also properly recognized the Postal Service's financial stability can be adversely affected where workshare discounts set below avoided costs result in operational inefficiency. Inefficient price signals may cause the Postal Service to "maintain a larger network or retain more processing operations than necessary."⁸ Thus, the Commission's

⁴ See PRC Dkt. No. R2006-1, Direct Testimony of John C. Panzar on behalf of Pitney Bowes Inc. (PB-T-1)(Oct. 31, 2006) at 18-19.

⁵ See PRC Dkt. No. MC95-1, Op. and Rec. Decision (Jan. 26, 1996) at ¶¶ 4237-38, 4256-57.

⁶ PRC Dkt. No. RM2017, Order No. 4257, Order on the Findings and Determination of the 39. U.S.C. § 3622 (Dec. 1, 2017) at 131.

⁷ *Id.*

⁸ Order 4257 at 216-17.

proposal was specifically designed to phase out both workshare discounts set substantially below and above avoided costs.⁹ GCA's proposal fails to address these issues entirely.

Moreover, the negative revenue effects of inefficient pricing signals are symmetrical. A simple illustration proves this point. In Case A, the Postal Service offers a \$0.11 discount for performing a certain workshare function which saves the Postal Service \$0.10. In this case, each time a mailer begins worksharing, the Postal Service loses \$0.01 in contribution because it gives a \$0.11 discount but only saves \$0.10 per piece. In Case B, the Postal Service offers a \$0.09 discount for the same workshare function that saves the Postal Service \$0.10. In this case, each time a mailer discontinues worksharing, the Postal Service loses \$0.01 in contribution because it receives \$0.09 in additional revenue by insourcing the work, but its costs increase by \$0.10 per piece. In both cases, inefficient pricing harms the Postal Service's finances.

GCA's proposal should be rejected as inconsistent with both Objectives 1 and 5; the asymmetric bands proposal would frustrate the goals of maximizing incentives to promote pricing and operational efficiency and would negatively affect the Postal Service's long-term financial stability.

B. The Commission's Implementation and Enforcement of the New Workshare Rules will be Critical to Realizing the Efficiency Goals of the PAEA

Several parties discussed implementation issues in their initial comments. Many of the positions are conflicting. The Commission should adopt a principles-based approach that seeks to accommodate those proposals that further the statutory objective of maximizing incentives to improve pricing and operational efficiency.

GCA urged the Commission to clarify that the statutory exceptions of section 3622(e)(2)-(3) are no longer part of the system once the new rules take effect. *See* GCA Comments at 20-

⁹ PRC Dkt. No. RM2017-3, Order 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products (Dec. 1, 2017) at 93.

21. The Postal Service, in contrast, urged the Commission to clarify that the statutory exceptions are still operative. *See* Initial Comments of the United States Postal Service (Postal Service)(Mar. 1, 2018) at 147. The Commission should resolve this ambiguity in its final rule.

The NPPC Comments urged the Commission to dispense with the three-year transition period, arguing that there is no justification for delaying the implementation of more efficient rate designs. *See* NPPC Comments at 44-45. The Postal Service urged the Commission extend the time allowed to bring workshare discounts into compliance within the established bands. *See* Postal Service Comments at 147-48. The Postal Service has not adequately explained why further delay is warranted. Case-by-case exceptions may be warranted, but wholesale delay would harm rather than promote pricing and operational efficiency.

Pitney Bowes and NPPC urge the Commission to clarify that the three-year transition period only applies to existing workshare discounts that are not currently in compliance, and that all workshare discounts must be moved successively closer to ECP and into compliance within the transition period. *See* Pitney Bowes Comments at 13-14; NPPC et al. Comments at 44 (“Mail currently within the band should remain within the band, and all workshare discounts outside of the band should move within the band.”). These proposed changes should be adopted as consistent with the stated intent of the proposed rule and the statutory objective to maximize incentives to reduce costs and improve efficiency.

GCA’s proposal to address multi-tier workshare passthrough calculations should be dismissed as an unnecessary complication; incremental, not cumulative, passthroughs are the relevant consideration for pricing efficiency. The Commission has consistently held that pricing efficiency focuses on the pricing signal from the relevant reference point or “benchmark” rate category, the rate category from which mail is most likely to convert (or to revert) in response to

changes in price differentials (incentives). This benchmark category is generally the next higher presort tier, making the relevant passthrough the incremental one. *See* Dkt. No. RM2009-3, Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology (Sept. 14, 2010) at 21. Therefore, changes to address multi-tier calculations to address potential cascading effects are not necessary because the cumulative passthroughs are much less important than incremental ones for pricing efficiency.

Enforcement of the proposed rules will also be essential. The Postal Service's statement that "practical experience" will ultimately prove the workability of the new approach is well taken. Postal Service Comments at 148. At the same time, the Postal Service's suggestion that it may consider eliminating certain workshare discounts to "avoid undue constraints on its pricing flexibility" should give the Commission pause. *Id.* Eliminating workshare discounts to evade compliance with pricing rules designed to promote efficiency would be contrary to the statutory objectives of the PAEA. Any suggestion that workshare discounts could be modified or eliminated for the purpose of evading rules designed to promote pricing and operational efficiency should raise serious concerns with the Commission.¹⁰

C. The Commission Properly Held that the Postal Service is Appropriately Allocating Institutional Costs Between Market Dominant and Competitive Products

GCA is the only party to challenge the Commission's determination that Objective 9, which requires that the Commission design a modern rate regulation system "to allocate the total institutional costs of the Postal Service appropriately between market dominant and competitive

¹⁰ *See e.g.*, Dkt. No. R2012-3, Order No. 987, Order on Price Adjustments for Market Dominant Products and Related mail Classification Changes (Nov. 22, 2011) at 10-12 (discussing Commission concerns with workshare pricing decisions that may have an adverse effect on the efficient operation of the Postal Service).

products,”¹¹ is satisfied by the statutory mechanisms established in sections 3633(a)(3) and 3633(b).¹²

GCA is incorrect when it states that the Commission’s interpretation of Objective 9 is unclear. The Commission clearly held that section 3622 does not prescribe a specific “amount to be allocated to market dominant products.”¹³ The Commission clearly held that Objective 9 was satisfied if there were a “mechanism to appropriately divide total institutional costs between market dominant and competitive products.”¹⁴ The Commission was also clear that the statute provides such a mechanism in sections 3633(a)(3) and 3633(b).¹⁵

Contrary to GCA’s arguments, interpreting Objective 9 in concert with sections 3633(a)(3) and 3633(b) harmonizes and gives effect to all of the relevant statutory provisions. The Commission’s reading avoids any conflict between the statutory provisions; Objective 9 is achieved through a more specific, complementary statutory provision which, by its terms, assures an “appropriate” allocation of institutional costs between market dominant and competitive products. Both provisions are given effect; thus, GCA’s argument that the Commission’s position renders Objective 9 redundant is incorrect. In contrast, the logical implication of GCA’s argument is that even if the Commission exercised its discretion under section 3633(b) to eliminate the minimum share requirement, Objective 9 must be read as imposing an “independent” obligation to allocate “some” minimum share of institutional costs to competitive products. This reading would invert the proper reading of the statute and nullify the specific authority granted to the Commission under section 3633(b). GCA’s position is therefore inconsistent with the commonplace rule of statutory construction that the specific governs the general. *See Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992); *see also HCSC–Laundry v. United States*, 450 U.S. 1, 6 (1981) (per

¹¹ 39 U.S.C. § 3622(b)(9)(Objective 9).

¹² Order No. 4257 at 246-47.

¹³ *Id.*, at 246.

¹⁴ Order No. 4257 at 243 (quoting Order No. 3673 at 10).

¹⁵ *Id.*, at 246-47.

curiam)(the specific governs the general “particularly when the two are interrelated and closely positioned, both in fact being parts of [the same statutory scheme]”).

The practical wisdom of the Commission’s interpretation is confirmed by the pendency of the parallel review of the allocation of institutional costs in Docket No. RM2017-1; there is no need for a duplicative process under section 3622(b)(9).

III. CONCLUSION

For the reasons stated above and in Pitney Bowes’ initial comments, the Commission’s proposed changes to the workshare regulations are improvements and should be adopted with modifications to maximize pricing and operational efficiency. Additionally, the Commission properly held that the current system contains a mechanism to appropriately allocate institutional costs, thus, no further action is required in this proceeding to address that issue.

Respectfully submitted:

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